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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 214

UNITED STATES OF AMERICA,
Petitioner,

v.

CUMBERLAND PUBLIC SERVICE COMPANY,
A CORPORATION.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF OF *AMICI CURIAE*

HUGH SATTERLEE,
THORPE NESBIT,
ROLLIN BROWNE,
Amici Curiae.

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BRIEF OF *AMICI CURIAE*

This brief, by permission of the Court and with the written consent of counsel for both parties, is filed by the undersigned as *amici curiae*.

THE QUESTION

The only question in the case is whether the taxpayer corporation sold its transmission and distribution facilities at a profit or distributed such properties as a liquidating dividend in kind to its stockholders, who in turn sold them.

THE DECISION BELOW

The Court of Claims "upon the evidence and the report of a commissioner" made special findings of fact to the effect that the two principal stockholders of the taxpayer (who thus controlled its corporate action) refused to permit the taxpayer to sell its properties but agreed as individuals with the would-be purchaser to take steps to acquire the properties themselves and sell them to the purchaser, which they did by procuring authorization from the other stockholders, having all the stock transferred to them, placing the taxpayer in liquidation and having the properties deeded to them, after which they conveyed to the purchaser and received the purchase price.

On those evidentiary facts, the Court of Claims concluded, in its opinion, that the properties had not been sold by the taxpayer, that there never had been any intention that the taxpayer would sell the properties, but that the properties had been distributed as a liquidating dividend to the stockholders who then as individuals had made the sale.

THE SCOPE OF REVIEW IN THIS COURT

The decision of the Court of Claims is reviewable in this Court only on questions of law. The findings of the Court of Claims are not reviewable but have the finality of a special verdict. It was the function of the Court of Claims, not only to find the evidentiary facts, but to weigh them and draw inferences from them and to make therefrom the ultimate finding or conclusion as to whether or not the sale had, in fact, been made by the taxpayer. Ct. Cls. Rule 75 (b); *United States* v. *Robert Esnault-Pelterie*, 299 U. S. 201; 303 U. S. 26.

This the Court of Claims did. Its ultimate finding or conclusion is stated in its opinion rather than as a finding of fact, as perhaps it should have been. Nevertheless, the Court left no doubt as to its views of the ultimate fact and, therefore, no good purpose would be served by remanding the case for such a "finding". *United States* v. *Wells*, 283 U. S. 102, 120-1.

THE QUESTION FOR THIS COURT

In the circumstances, this Court will not reverse the judgment below unless it concludes that *as a matter of law* an ultimate finding by the Court of Claims that the taxpayer did not sell the properties could not be supported on any hypothesis. *United States* v. *Wells, supra; United States* v. *Robert Esnault-Pelterie*, 303 U. S. 26. Bearing in mind that the findings of the Court of Claims do not purport to set forth all the evidence, it follows that the only question presented in this Court is whether a corporation incurs income tax liability by declining an offer for its property and then dissolving and distributing the property in kind to its stockholders who sell to the would-be purchaser on the same terms.

THE GOVERNMENT RAISES A FALSE ISSUE

The Government, in its petition for certiorari, did not even pretend to present the issue actually involved in this case, but dragged in all sorts of extraneous matter entirely foreign to the facts as found below, in an attempt, through a strange mixture of fact and fiction liberally spiced with invective, to make this Court believe that there is involved a mere pretended or fictitious course of conduct undertaken solely to cloak the real transaction and thus avoid a proper and normal tax burden.

The Government said in its petition that a double tax on appreciation in the value of corporate assets realized on liquidation is "the normal incidence of the fact that Congress has seen fit to tax the corporation and its stockholders as separate entities", but that "it has become the fashion to attempt to avoid" this normal burden "by going through the motions" of distributing the property to the stockholders who then sell "as though they were the individual owners" (p. 8). It was charged that a liquidating distribution is used as "one of the formalisms * * * to avoid the appearance of a transaction which would be taxable to the corporation, as would plainly be true in the case of a direct sale by the corporation" (*id.*).

In its brief on the merits the Government says that the liquidating distribution "was used only as a form to cloak a sale of the corporation's property, and was a meaningless step whereby there was a circuitous routing of title to the ultimate purchaser, the stockholders acting as pure conduits" (p. 9); and that the issue is whether a corporation can escape tax "on corporate gains" by having its property "routed to the stockholders under the guise of a liquidation distribution" (p. 10).

The real issue in the case is far different. It is whether stockholders of a corporation have the legal right to liquidate the corporate venture, take title to the assets and deal with them as individual owners without thereby subjecting the corporation to tax as though it had continued to own and deal with them in the conduct of a corporate enterprise.

Having thus befogged the issue, the Government then proceeds woefully to misconstrue the decision of the Court below, saying, in its petition, that the Court had "quite erroneously, assumed that the ultimate question depends upon who appears to be the formal vendor", and that the

Court had concluded that no gain could be attributed to the taxpayer because the stockholders and officers had "purported to act in their individual capacities" (p. 9). In its brief on the merits the Government goes so far as to say (pp. 10-11) that the Court of Claims had held that "there can be a successful evasion of the corporate tax merely because a liquidation distribution, which is one in form alone and is not intended to invest the stockholders with ownership of the property, has been interjected in an attempt to obscure the fact that it is the corporation's property which has been sold".

The actual decision below was far different. It was merely that the corporation had been dissolved, the corporate venture liquidated and the stockholders had acquired the assets through a distribution in kind and had then sold them as individuals, there never having been any intention or desire that the corporation sell them.

AS TO THE "NORMAL INCIDENCE" OF DOUBLE TAXATION OF CORPORATE INCOME

The Government's entire case rests on the false assumption that double taxation of corporate income is a major desideratum of our tax law and that any arrangement of business transactions so as to avoid the extra tax is wholly reprehensible. The assumption will not bear analysis.

Originally the corporate income tax was designed merely as complementary to the personal income tax. The rate of the corporate tax was the same as the rate of the normal personal tax, from which corporate dividends were exempted. In the later desperate search for additional revenues, that notion of the proper function of the corporate tax has been abandoned, but its abandonment is scarcely anything to which we can point with pride. It is, rather,

generally recognized as one of the more serious defects in our tax system. Economic and fiscal experts of all shades of opinion have repeatedly urged relief from the oppressive and stifling burden of the double taxation of corporate income. Practically every plan advanced for tax reform following the Second World War has made such relief one of its prime recommendations.[1] It is highly probable that such a reform has been delayed only by the pressing need for revenue and, to a lesser extent, by the difficulty of agreeing upon some form of relief administratively more practical than the British credit system.

Meanwhile, a partial defense of the present inequitable and unsound system has been that doing business in corporate form is a valuable privilege for which some additional tax burden may fairly be imposed. Another partial defense has been that the Government cannot defer its tax until corporate income is divided among the stockholders; revenue needs are too urgent and, moreover, the income might later be lost in new ventures so that the tax never would be paid. We need not determine whether those are good defenses. We need only to note that they have no application to the double taxation of capital gains incident upon the *cessation of corporate business.*

When a corporation is dissolved, the special privilege of doing business in corporate form is relinquished. Any profit which may flow from the discontinuance of the corporate enterprise inures immediately and directly to the individual stockholders from whom the appropriate tax can be collected at once.

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[1] A review of several of these recommendations and a comprehensive study of the entire problem may be found in an article entitled "Integrating Federal Income Taxes on Corporations and Their Shareholders", by Professor Othel D. Westfall, in Taxes (The Tax Magazine) for March, 1949, at page 236.

Finally, in the instant case (and in most such cases) the profit in question is not ordinary income but is capital gain. Other countries get along quite well without taxing such gains at all; there can be no special pride in taxing them twice.

Congress evidently has recognized the considerations just mentioned and has been careful in all our tax laws to give the owners of corporate business an option to avoid the burden of the double tax upon the abandonment and liquidation of the corporate venture.

The statute and regulations will be fully set forth in the briefs filed by the parties herein, and it is unnecessary to prolong this brief by an analysis of them. The Government hints, without directly stating, that the scheme of the statute and regulations permitting the avoidance of the corporate tax on liquidation was intended to apply only where the stockholders intend to retain the corporate property, and presumably continue to operate the corporate venture, indefinitely, but that it was not intended to apply where the sole purpose of the stockholders was the immediate liquidation of the corporate business by a sale of the property. That, indeed, would be a curious interpretation to place upon the Congressional intent. It simply defies all reason and logic to assume that Congress would extend an opportunity for relief from double taxation in cases where the corporate business is continued in unincorporated form, but to deny such relief where the business enterprise is entirely abandoned.

But, the Government suggests, the "gain" or appreciation in the corporate assets "accrued" to the corporation and, therefore, belonged to it as of right. The answer is that such is not always the case. The appreciation may have occurred before the property was acquired by the

corporation and even while it was owned by the very same individuals who, as stockholders, received it on liquidation. A quite common situation would be as follows: A group of individuals start business as a partnership, acquiring a plant at a cost of, say, $50,000; later, when the plant is worth $100,000, the business is incorporated, the partners receiving stock in exchange for the property; then later, when the plant is still worth $100,000, the corporation is dissolved and the business liquidated. In such a case, if the corporation should sell the property and distribute the proceeds to the stockholders, there would be a double tax (corporate and individual) on the single profit of $50,000, every dollar of which would have accrued to and been realized only by the individuals. If, on the other hand, the stockholders should take the property out of the corporation and sell it as individuals, thus realizing and paying tax on their own profit, could it be said that their action was in any way reprehensible or that they had "evaded" or even "avoided" a "normal incidence" of taxation which Congress intended they should bear?

For all that appears in this record, the situation just described may actually have existed in this case.

It is true that in many similar situations, because of the number of stockholders, the nature of the property or the corporate indebtedness, or some combination of one or more of those factors, the property cannot be distributed to the stockholders but must be sold by and for account of the corporation. In such cases, of course, the corporate tax must be paid under existing law, and the imposition of the corporate tax in such a situation may possibly be justified because of the fact that the use of the corporate form was actually required in order to make the sale. But if the stockholders can and do actually take over the property and

sell it as individuals, there should be no special effort at casuistry to disregard what they did simply because if they had not been able to do it or had not actually done it, the extra tax would have been incurred.

Perhaps, if the transaction is not clear-cut so that doubt remains as to precisely what was done, the courts are justified in resolving the doubt against the taxpayers since they had it in their power to leave a clear, unambiguous record. But there is strong feeling in various quarters that some courts have leaned over too far in imputing sales to corporations in liquidation. See, for example, *Court Holding Company* v. *Commissioner*, 2 T. C. 531, rev'd. 143 F. (2d) 823, rev'd. 324 U. S. 331; *Fairfield S. S. Corp.* v. *Commissioner*, 157 F. (2d) 321, cer. den. 329 U. S. 774. At any rate, those decisions focused attention sharply on the problem, as a result of which a strong demand has arisen for an amendment of the law to provide that such a gain shall not be taxed to the corporation even where it admittedly makes the sale and distributes the cash proceeds among the stockholders. This demand has not gone entirely unheeded in the halls of Congress.

In the Revenue Revision Bill of 1948 (H. R. 6712), which passed the House in June, 1948, but was not reached in the Senate before adjournment, just such a provision was included as Section 129. The House Committee on Ways and Means in its report accompanying the bill[2] pointed out that a double tax was incurred on liquidation if the corporation sold and distributed the proceeds, whereas only one tax was incurred if the property was distributed and the sale made by the stockholders. The Committee then said:

> "The two methods of liquidation are essentially the same, and your committee believes there is no

[2] House Report No. 2087, 80th Congress, 2nd Session, p. 15.

justification for subjecting the second method to discriminatory tax treatment, particularly since this method represents, in most cases, the more efficient form of liquidation."

H. R. 6712 and the accompanying report throw some light on the attitude of Congress toward the problem involved in this case. The action taken by the House presages prompt Congressional repudiation of any adoption of the Government's philosophy as to the "normal incidence" of the double tax on corporate liquidations.

CONCLUSION

From the inception of our income tax law it has been the rule that a corporation in liquidation may distribute its property to its stockholders who may sell and divide the proceeds among themselves without incurring the burden of double taxation which normally falls on corporate income. The Court of Claims held that that is precisely what occurred in this case. This Court will not review the finding of the Court of Claims as to what actually occurred and, therefore, the judgment below should be affirmed.

Respectfully submitted,

HUGH SATTERLEE,
THORPE NESBIT,
ROLLIN BROWNE,
Amici Curiae.

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